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1984 Dodge/Sweet's Construction Outlook

Second Update
July 1984

Goodbye Housing... Hello Commercial

After two years of recovery, the dynamics of the building cycle are shifting from residential to nonresidential building. Ordinarily this would mean that the best is yet to come as the combination of sustained high-level housing activity and still-expanding commercial and industrial contracting brings the cycle to its peak during the third year. However, the premature rise of interest rates early in 1984 is threatening to bring this cycle to an early end as housing appears headed for a second-half decline. In the light of this development, the short term construction outlook is reduced to two questions:

- How steep will be the decline of housing starts in the months ahead?
- Is there enough potential in the commercial and industrial building sectors to cover the expected decline of homebuilding?

The Interest Rate Issue

There are several reasons why interest rates should be coming *down*, but they aren't convincing when matched against the Federal deficit as the reason why they are rising instead. Until the deficit's dominance of the credit market is relieved (and that won't happen in 1984), the present "loose fiscal/tight monetary" environment will have to be endured.

As the Federal Reserve restricts the growth of the supply of credit, the combined demands of the Treasury (which is pre-empting more than half of the economy's savings in order to finance its deficits) and the business sector (which is only now warming up to a strong wave of capital spending) are pushing rates higher. Under the circumstances, it is only a matter of time before housing starts begin to wither.

This uncomfortable situation isn't going to change much until the underlying problem—the deficit that everybody loves to hate—is addressed in a meaningful way. Proposals for deficit reduction that are now under consideration by Congress should eventually allow the Fed to relax its grip on the credit market by substituting fiscal restraint for monetary restraint. But whatever compromise solution is reached over the summer won't become effective until 1985 at the earliest, leaving interest rates hanging high for several quarters.

How high will interest rates go before turning down again? Are we on another trip to the realm of the 20 percent prime and the 18 percent mortgage?

Economic priorities are not the same in 1984 as they were in 1980. Sustaining growth now takes precedence over driving inflation out of the system (at least until it can be shown that inflation is galloping again). Concern about third world debtors adds a new dimension to credit policy. In line with these priorities, the interest rate assumptions underlying this forecast of construction activity are:

- Rates are close to the limit of their current upswing, but will continue to drift a bit higher through the second half of 1984 and into early 1985.
- There is the opportunity for a reversal of interest rates by the middle of 1985 when economic activity will have slowed considerably, and when fiscal policy will begin to address the deficit issue.

Housing

Through mid-1984, at least, the one-point-plus hike in mortgage rates had not yet turned the housing cycle down. Outstanding commitments at more favorable terms were still supporting a strong 1.9 million unit rate of starts in the month of May, although the forces of decline were already in motion.

One-family housing starts averaged 1.05 million units (annual rate) through 1984's first half with only a modest (5 percent) fall-off in the second quarter. If mortgage rates, which have recently advanced from 13 percent to 14 percent,

do not reach 15 percent by the end of the year, recent experience at these lofty levels indicates that a fourth-quarter rate of 925,000 one-family housing starts remains possible.

As the year's stronger first-half volume is eroded by rising interest rates during the third and fourth quarters, 1984's one-family housing potential must be adjusted back to 1.0 million units—approximately even with 1983's total, but moving in the opposite direction.

Multi-family housing is headed for an extraordinary 800,000 unit volume in 1984—the largest total since the early 1970's. Instead of leveling off at about 650,000 units, a rate that would have been consistent with the 1.1 million unit peak reached by one-family housing last winter, multi-family building soared to 800,000 units where it still remains. The obvious implication: something besides the respite in interest rates has been stimulating multi-family building during the past several quarters.

Life styles of the 1980's, as much as the high cost of conventional one-family houses, are responsible for the popularity of condominiums as the starter home for many young families. But in addition, accelerated depreciation has triggered a minor boom in apartment construction.

Rising mortgage rates are bound to lead to a weakening of the condo market during 1984's second half, but tax-sheltered apartments are likely to remain an active market for a while longer as the probability grows that terms will be less favorable to investors in 1985.

Total housing starts in 1984's second half are expected to average 1,740,000. This compares with the 1,860,000 rate reached during the first half when the housing cycle was rounding its peak, and should bring the year's total to an even 1.80 million units.

Maximum stress of rising interest rates is most likely to bear on the housing market during the middle quarters of 1985, when the rate of starts is tentatively forecast to sink as low as 1,550,000 units. An improved final quarter is expected to bring next year's total to 1,575,000 units.

1984 National Estimates
Dodge Construction Potentials

Second Update July 1984

		1983 Actual	1984 Forecast	Percent Change 1984/83
Nonresidential Buildings				
Floor Area (millions of square feet)	Office Buildings	281	275	– 2
	Stores & Other Commercial	362	480	+33
	Manufacturing Buildings	107	140	+31
	Total Commercial & Manufacturing	750	895	+19
	Educational	73	76	+ 4
	Hospital & Health	84	76	–10
	Other Nonresidential Buildings	116	118	+ 2
	Total Institutional & Other	273	270	– 1
	Total Nonresidential Buildings	1,023	1,165	+14
Contract Value (millions of dollars)	Office Buildings	$ 19,766	$ 20,100	+ 2
	Stores & Other Commercial	13,798	18,375	+33
	Manufacturing Buildings	5,080	6,900	+36
	Total Commercial & Manufacturing	$ 38,644	$ 45,375	+17
	Educational	$ 6,157	$ 6,900	+12
	Hospital & Health	8,560	8,325	– 3
	Other Nonresidential Buildings	8,544	8,975	+ 5
	Total Institutional & Other	$ 23,261	$ 24,200	+ 4
	Total Nonresidential Buildings	$ 61,905	$ 69,575	+12
Residential Buildings				
Dwelling Units* (thousands of units)	One-Family Houses	1,000	1,000	—
	Multi-Family Housing	719	800	+11
	Total Housekeeping Residential	1,719	1,800	+ 5
Floor Area (millions of square feet)	One-Family Houses	1,578	1,578	—
	Multi-Family Housing	682	769	+13
	Nonhousekeeping Residential	78	97	+24
	Total Residential Buildings	2,338	2,444	+ 5
Contract Value (millions of dollars)	One-Family Houses	$ 61,765	$ 65,525	+ 6
	Multi-Family Housing	25,919	30,400	+17
	Nonhousekeeping Residential	5,517	7,100	+29
	Total Residential Buildings	$ 93,201	$103,025	+11
Nonbuilding Construction				
Contract Value (millions of dollars)	Highways & Bridges	$ 15,219	$ 17,825	+17
	Sewer & Water	7,536	7,425	– 1
	Other Public Works	7,210	8,050	+12
	Total Public Works	$ 29,965	$ 33,300	+11
	Utilities	$ 7,680	$ 5,000	–35
	Total Nonbuilding Construction	$ 37,645	$ 38,300	+ 2
All Construction				
Contract Value (millions of dollars)	Total Construction	$192,751	$210,900	+ 9
	Dodge Index (1977 = 100)	138	151	

*F.W. Dodge basis

Nonresidential Building

The nonresidential building cycle, in typical fashion, is a year behind the housing market, leaving much of its potential still to be realized. For forecasting purposes, the several building types that make up this group can be put into two classes: safe, and risky. Most prominent among the "safe" categories (i.e., high assurance of continued gains): stores, warehouses, manufacturing buildings.

The retail building market (stores and warehouses) is on its way to two years (1984 and 1985) of high-volume building as it responds to needs created by the recent surge of residential building. This year's strong 1.8 million unit volume of housing starts is capable of supporting as much as 425 million square feet of retail building, but owing to the normal lag in this building market, the impact of 1984's homebuilding on contracting for stores and warehouses will be diffused throughout 1984 and 1985. Total volume of slightly more than 400 million square feet is anticipated for both years (vs. 300 million in 1983) as contracting in the retail building market achieves its peak early in 1985.

By the time the economy's expansion reaches its limit (in 1987), manufacturers will be operating at about 86 percent of capacity—a rate not often exceeded. And by that time, contracting for *industrial*

1984 Regional Estimates
Dodge Construction Potentials

Second Update
July 1984

Northeast	CT, ME, MA, NH, NJ, NY, PA, RI, VT	1983 Actual	1984 Forecast	Percent Change 1984-83
Contract Value (millions of dollars)	**Nonresidential Buildings**			
	Commercial and Manufacturing	$ 5,972	$ 7,300	+22
	Institutional and Other	4,160	4,350	+ 5
	Total	$10,132	$11,650	+15
	Residential Buildings			
	One-Family Houses	$ 6,871	$ 7,675	+12
	Multi-Family Housing	3,607	4,175	+16
	Nonhousekeeping Residential	986	1,125	+14
	Total	$11,464	$12,975	+13
	Nonbuilding Construction			
	Highways and Bridges	$ 2,387	$ 3,075	+29
	Other Public Works	2,830	2,925	+ 3
	Utilities	313	400	+28
	Total	$ 5,530	$ 6,400	+16
	Total Construction	$27,126	$31,025	+14

South	AL, AR, DE, DC, FL, GA, KY, LA, MD, MS, NC, OK, SC, TN, TX, VA, WV	1983 Actual	1984 Forecast	Percent Change 1984-83
Contract Value (millions of dollars)	**Nonresidential Buildings**			
	Commercial and Manufacturing	$15,575	$17,875	+15
	Institutional and Other	8,941	9,450	+ 6
	Total	$24,516	$27,325	+11
	Residential Buildings			
	One-Family Houses	$29,148	$29,775	+ 2
	Multi-Family Housing	12,686	14,200	+12
	Nonhousekeeping Residential	2,386	3,175	+33
	Total	$44,220	$47,150	+ 7
	Nonbuilding Construction			
	Highways and Bridges	$ 5,786	$ 6,350	+10
	Other Public Works	5,259	5,500	+ 5
	Utilities	2,151	2,000	– 7
	Total	$13,208	$13,850	+ 5
	Total Construction	$81,944	$88,325	+ 8

North Central	IL, IN, IA, KS, MI, MN, MO, NE, ND, OH, SD, WI	1983 Actual	1984 Forecast	Percent Change 1984-83
Contract Value (millions of dollars)	**Nonresidential Buildings**			
	Commercial and Manufacturing	$ 7,314	$ 8,825	+21
	Institutional and Other	4,513	4,700	+ 4
	Total	$11,827	$13,525	+14
	Residential Buildings			
	One-Family Houses	$ 9,867	$10,475	+ 6
	Multi-Family Housing	3,211	3,950	+23
	Nonhousekeeping Residential	683	975	+43
	Total	$13,761	$15,400	+12
	Nonbuilding Construction			
	Highways and Bridges	$ 4,204	$ 5,125	+22
	Other Public Works	3,011	3,125	+ 4
	Utilities	1,376	900	–35
	Total	$ 8,591	$ 9,150	+ 7
	Total Construction	$34,179	$38,075	+11

West	AK, AZ, CA, CO, HI, ID, MT, NV, NM, OR, UT, WA, WY	1983 Actual	1984 Forecast	Percent Change 1984-83
Contract Value (millions of dollars)	**Nonresidential Buildings**			
	Commercial and Manufacturing	$ 9,783	$11,375	+16
	Institutional and Other	5,647	5,700	+ 1
	Total	$15,430	$17,075	+11
	Residential Buildings			
	One-Family Houses	$15,879	$17,600	+11
	Multi-Family Housing	6,415	8,075	+26
	Nonhousekeeping Residential	1,462	1,825	+25
	Total	$23,756	$27,500	+16
	Nonbuilding Construction			
	Highways and Bridges	$ 2,830	$ 3,275	+16
	Other Public Works	3,646	3,925	+ 8
	Utilities	3,840	1,700	–56
	Total	$10,316	$ 8,900	–14
	Total Construction	$49,502	$53,475	+ 8

buildings, at 215 million square feet, will be approximately double last year's poor showing of only 107 million square feet. Between those extremes lie several years of prospective gains.

In 1984's first quarter, when capacity utilization had already advanced to 81 percent, the rate of industrial building—120 million square feet—was clearly not keeping up with the rapid pace of economic activity. Quarter-by-quarter gains in contracting are expected to bring the fourth quarter rate to 160 million square feet, putting the year's total at an estimated 140 million. Another sizable gain in 1985 is indicated.

A few other nonresidential building types which are mainly derivatives of homebuilding—e.g., religious, social and recreational facilities—can also be included in the group of "safe" short-run gains. Examples of "risky" building markets where special situations are more important than general trends include offices, hospitals and health care facilities.

"Precarious" is as good a word as any to describe the current state of the office building market. The extraordinary office building boom of the past five years, which produced as much new office space as was built in the previous ten years, began with the firm support of strong demographics. After satisfying the

space needs of a rapidly growing white collar labor force, the boom was ready to call it quits in 1982. Instead, it was kept alive by a change in depreciation rules which turned into a speculative bubble sustained by tax shelters.

As Congress bends to the task of preparing a fiscal package of taxation and spending cuts designed to reduce the deficit, tax shelters are high on the hit list. The anticipation by real estate investors of the inevitable loss of some (not all) of the advantages of a 15-year write-off probably had a lot to do with the resurgence of office building in 1984's second quarter when contracting soared above 300 million square feet.

So it becomes necessary to raise the 1984 forecast of office building to bring it into line with (un)reality. The possibility that some projects that had been planned for 1985 are being accelerated in order to qualify for present depreciation schedules is reason to expect a total of as much as 275 million square feet in 1984—virtually even with last year's strong volume. In 1985, a sharper drop (to about 200 million square feet) may now be indicated.

The hospital/health care building market is faced with another new source of uncertainty—the control of runaway Medicare/Medicaid expenses by adherence to standardized costs (Diagnostic Related Groups). As hospital administrators become increasingly cost-conscious in their attempt to deliver medical care at DRG prices, targeted areas of economy are (1) payrolls, and (2) length of patient stay. In both cases, success in controlling these costs ultimately translates into a reduced need for space.

Our current estimate of contracting in 1984 reflecting experience to date is a decline of nearly 10 percent.

With more "safe" than "risky" elements to the nonresidential building outlook, 1984's contracting is now adjusted upward to 1,165 million square feet for an advance of 14 percent over the 1983 total.

Public Works Construction

Partly due to a technicality, 1984 contracting for public works construction is headed for a double-digit gain over last year's total.

The Surface Transportation Assistance Act, which was the biggest event in the public works arena in a long time, began dispensing approximately $5 billion extra annual funding for highways, bridges, and mass transit in 1983's *second* quarter, and is still going strong. This means, simply, that in 1984 this new program will be operational for a full year after last year's late start. The result: an "automatic" increase in highway/bridge construction this year of 15 percent or more.

Other public works construction contracting (for water resources, sewer and waste treatment facilities, etc.) was running a bit ahead of forecast in 1984's first half, presumably because many state and local governments found themselves with unexpectedly large budget surpluses.

Total public works construction for all of 1984 is now estimated to reach $33.3 billion, a gain of 11 percent over 1983's value.

This last look at 1984 reveals a construction market that will be considerably different by the end of the year than it was at the beginning. Before midyear, rising interest rates were bringing the housing cycle to a premature end. During the remainder of the year, nonresidential building will be increasingly dominant.

To a large extent, this is the normal sequence of cyclical development, but events since the start of the year are accelerating the process.

Nevertheless, there remains enough momentum in the nonresidential markets to carry 1984's contracting for total new construction forward another 9 percent to a record $210.9 billion.

The construction sector will be put to a more severe test in 1985 when the big issue will be: Will the deficit problem be addressed seriously enough to relieve the pressure on interest rates so housing can recover?

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George A. Christie
Vice President and Chief Economist

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The Outlook

Nonresidential Building Contract Value

Seasonally adjusted annual rates, in billions of dollars

Year/Quarter		Total	Commercial/ Industrial	Institutional
1983	I	$59.5	$37.2	$22.3
	II	60.1	36.4	23.7
	III	63.1	40.2	22.9
	IV	64.8	40.6	24.2
1984	I	$67.3	$43.6	$23.7
	II	72.8	49.0	23.8
	III	69.6	45.3	24.3
	IV	68.6	43.7	24.9
1983		$61.9	$38.6	$23.3
1984		$69.6	$45.4	$24.2
% Change		+12	+17	+ 4

Residential Building Contract Value

Seasonally adjusted annual rates, in billions of dollars

Year/Quarter		Total	One-Family	Multi-Family*
1983	I	$ 84.5	$57.1	$27.4
	II	92.7	63.9	28.8
	III	99.1	63.7	35.4
	IV	96.4	62.3	34.1
1984	I	$104.9	$70.0	$34.9
	II	106.3	67.7	38.6
	III	101.9	63.6	38.3
	IV	99.0	60.8	38.2
1983		$ 93.2	$61.8	$31.4
1984		$103.0	$65.5	$37.5
% Change		+11	+ 6	+19

*Includes Nonhousekeeping Residential Buildings

Nonbuilding Construction Contract Value

Seasonally adjusted annual rates, in billions of dollars

Year/Quarter		Total	Public Works	Utilities
1983	I	$31.8	$25.8	$ 6.0
	II	48.8	32.1	16.7
	III	38.8	32.3	6.5
	IV	31.2	29.6	1.6
1984	I	$35.8	$33.0	$ 2.8
	II	36.4	32.2	4.2
	III	40.0	34.0	6.0
	IV	41.0	34.0	7.0
1983		$37.7	$30.0	$ 7.7
1984		$38.3	$33.3	$ 5.0
% Change		+ 2	+11	−35

1985 Dodge/Sweet's Construction Outlook

First Update
March 1985

Reaching For The Peak

The building market is doing what it usually does during the middle years of its cyclical development: It is moving over to the slow lane.

1983 and 1984 were the years of maximum acceleration. From almost a dead stop that lasted from 1980 to 1982 (when the value of new construction contracting failed to break out of the $150 to $160 billion range), contracting leaped 23 percent in 1983 to $194 billion. That surge was followed by an 8 percent gain in 1984 to $210 billion. From there the numbers will keep getting bigger for a while longer, but the gains will continue to diminish. The 1985 advance will shrink to 5 percent as total construction contract value reaches $221.0 billion, and will be followed by a mere 2 percent increase in 1986.

After adjustment for inflation, *real* (constant dollar) expansion of the construction cycle will be reaching its limit in 1985, and by 1986 the building market will be rounding another peak. This means that the next two years—1985 and 1986—are likely to be the best of the current crop.

What To Watch For in '85

Last year opened with strong housing activity (which subsequently faded), and closed with equivalent strength in nonresidential building. The emergence of the dormant commercial and industrial building sector—a more or less normal mid-cycle event—was what kept the construction market's two-year-old expansion alive.

As 1985 opened, construction contracting continued to advance—from December's $211 billion (seasonally adjusted annual rate) to $215 billion in January. But in January it was homebuilding (and also public works construction) that moved the market ahead, while nonresidential building settled back. After last year's 24 percent surge of commercial and industrial building, January's shift could be the signal for another change of emphasis—this time in favor of residential building.

Two market pressures—one positive and the other negative—lend support to such a reversal. On the plus side: Single-family homebuilding has yet to respond to the decline of mortgage rates that has been under way since late last summer. (January's housing gain was exclusively in multi-family units.) This potential should be coming through in 1985. The minus: Office building is highly vulnerable, and may already be on the way to an extended correction for the overbuilding that has been encouraged by accelerated depreciation. These two categories, one-family housing and offices, are the ones to watch closely in 1985.

Commercial Building: A Premature Peak

The current cycle of commercial and industrial building is taking on a unique configuration. In contrast to the typical pattern of steady expansion over a period of three or more years, followed by sharp contraction, this cycle—which began late in 1982—appears to have topped out after only eight quarters of expansion. Its premature peak is a low one by recent standards, but should be followed by an unusually gentle decline stretching over the next several years. The reason: divergent movements in the three major components of commercial and industrial building.

For the next few years, retail building will be holding steady at its current 425 to 450 square foot rate of contracting. Office building, which soared to 330 million square feet in 1984 II, is now edging down and its decline will soon accelerate. Industrial building, temporarily stalled at just short of 150 million square feet, has the potential to climb to 200 million square feet before the next recession sets in.

Because the anticipated decline of office building will carry considerable weight in the near future, the direction of total commercial and industrial building will be generally downward through the mid-1980's, but the continued support of

retail and industrial building will cushion the fall. The net result: an almost plateau-like appearance to the total commercial and industrial building market through 1987. Ultimately, as the economy slips into general recession toward the end of the decade, the cyclical decline of commercial and industrial building will degrade into a typical across-the-board retreat. For the short term, however, recession is not a serious threat. With capacity utilization at 82 percent and unemployment at 7 percent, the economy has plenty of room to grow, and more than enough deficit spending to keep it growing.

Contracting for retail buildings (stores and warehouses) reached a rate of 420 million square feet in 1984's second half, a level that is consistent with a volume of housing starts in the range of 1.7 million to 1.8 million units. Since 1.8 million dwelling units is the best expectation for the housing sector any time in the foreseeable future, it would appear that retail building has gone about as far as it is going for a while.

Because the volume of homebuilding is likely to remain close to 1.8 million units through 1985 and 1986, the demand for retail building is headed for an extended stretch of contracting at its present high level. Allowing for a short lag (which has the effect of smoothing out quarter-to-quarter variations in homebuilding as demand is subsequently transferred to retail building), contracting for stores and warehouses is estimated to hold steady in the narrow range of 420 million to 430 million square feet for the next two years.

In response to the economy's vigorous 1983-84 recovery, and encouraged by tax incentives, contracting for industrial construction surged 60 percent between 1983 I and 1984 II. For the rest of 1984, however, contracting for manufacturing buildings remained frozen in its tracks. The reason: The brief round of monetary restraint that was applied to check the economy's runaway expansion inevitably led to a dip in industrial production and a setback in capacity utilization.

The general economic outlook for 1985 has brightened appreciably in the past month or two, but last year's close encounter with "growth recession" is likely to eclipse the industrial building market through the first half of the year. In 1985, the completion of last year's large increase of newly started industrial construction, along with slower industrial growth and continued problems in export markets for U.S. manufacturers, will combine to hold the capacity utilization rate below 83 percent. Under such circumstances, contracting for new plant capacity will be inhibited until some of the current surplus is absorbed. In 1985, this implies a year of only modest improvement in industrial construction, and the short-term forecast has been scaled down to 150 million square feet (up 5 percent from 1984's 143 million). Most of this gain will be concentrated in the second half.

For the second time in the 1980's the office building boom appears to be receding from an extraordinary peak. The first one came in 1981:I when the rate of contracting soared to a record 355 million square feet. A year later, as the booming Southwest began to cool down, contracting for office buildings was declining sharply. But a little more than a year after that, the stimulus of greatly liberalized depreciation schedules triggered a secondary building boom in major cities and their suburbs all over the nation.

1985 National Estimates Dodge Construction Potentials

First Update March 1985

		1984 Actual	1985 Forecast	Percent Change 1985/84
Nonresidential Buildings				
Floor Area (millions of square feet)	Office Buildings	317	275	– 13
	Stores & Other Commercial	477	496	+ 4
	Manufacturing Buildings	143	150	+ 5
	Total Commercial & Manufacturing	937	921	– 2
	Educational	89	95	+ 7
	Hospital & Health	71	72	+ 1
	Other Nonresidential Buildings	122	132	+ 8
	Total Institutional & Other	282	299	+ 6
	Total Nonresidential Buildings	1,219	1,220	—
Contract Value (millions of dollars)	Office Buildings	$ 22,917	$ 20,975	– 8
	Stores & Other Commercial	18,465	19,800	+ 7
	Manufacturing Buildings	7,141	7,650	+ 7
	Total Commercial & Manufacturing	$ 48,523	$ 48,425	—
	Educational	$ 7,569	$ 8,125	+ 7
	Hospital & Health	7,217	7,550	+ 5
	Other Nonresidential Buildings	9,959	10,700	+ 7
	Total Institutional & Other	$ 24,745	$ 26,375	+ 7
	Total Nonresidential Buildings	$ 73,268	$ 74,800	+ 2
Residential Buildings				
Dwelling Units* (thousands of units)	One-Family Houses	1,001	1,050	+ 5
	Multi-Family Housing	747	725	– 3
	Total Housekeeping Residential	1,748	1,775	+ 2
Floor Area (millions of square feet)	One-Family Houses	1,578	1,648	+ 4
	Multi-Family Housing	714	707	– 1
	Nonhousekeeping Residential	92	90	– 2
	Total Residential Buildings	2,384	2,445	+ 3
Contract Value (millions of dollars)	One-Family Houses	$ 66,849	$ 73,325	+10
	Multi-Family Housing	27,597	28,625	+ 4
	Nonhousekeeping Residential	6,425	6,500	+ 1
	Total Residential Buildings	$100,871	$ 108,450	+ 8
Nonbuilding Construction				
Contract Value (millions of dollars)	Highways & Bridges	$ 17,158	$ 18,025	+ 5
	Sewer & Water	8,098	8,600	+ 6
	Other Public Works	8,143	8,125	—
	Total Public Works	$ 33,399	$ 34,750	+ 4
	Utilities	$ 2,485	$ 3,000	+21
	Total Nonbuilding Construction	$ 35,884	$ 37,750	+ 5
All Construction				
Contract Value (millions of dollars)	Total Construction	$210,023	$221,000	+ 5
	Dodge Index (1977 = 100)	149	157	

*F.W. Dodge basis

1985 Regional Estimates
Dodge Construction Potentials

First Update
March 1985

Northeast

CT, ME, MA, NH, NJ, NY, PA, RI, VT

Contract Value (millions of dollars)	1984 Actual	1985 Forecast	Percent Change 1985/84
Nonresidential Buildings			
Commercial and Manufacturing	$ 8,183	$ 7,950	− 3
Institutional and Other	4,467	4,800	+ 7
Total	$12,650	$12,750	+ 1
Residential Buildings			
One-Family Houses	$ 8,665	$ 9,675	+12
Multi-Family Housing	3,598	3,750	+ 4
Nonhousekeeping Residential	880	900	+ 2
Total	$13,143	$14,325	+ 9
Nonbuilding Construction			
Highways and Bridges	$ 3,246	$ 3,200	− 1
Other Public Works	3,119	3,300	+ 6
Utilities	314	400	+27
Total	$ 6,679	$ 6,900	+ 3
Total Construction	$32,472	$33,975	+ 5

South

AL, AR, DE, DC, FL, GA, KY, LA, MD, MS, NC, OK, SC, TN, TX, VA, WV

Contract Value (millions of dollars)	1984 Actual	1985 Forecast	Percent Change 1985/84
Nonresidential Buildings			
Commercial and Manufacturing	$18,536	$18,800	+ 1
Institutional and Other	9,444	9,900	+ 5
Total	$27,980	$28,700	+ 3
Residential Buildings			
One-Family Houses	$30,230	$32,600	+ 8
Multi-Family Housing	12,384	12,450	+ 1
Nonhousekeeping Residential	2,732	2,825	+ 3
Total	$45,346	$47,875	+ 6
Nonbuilding Construction			
Highways and Bridges	$ 6,128	$ 6,525	+ 6
Other Public Works	5,833	6,000	+ 3
Utilities	1,394	1,500	+ 8
Total	$13,355	$14,025	+ 5
Total Construction	$86,681	$90,600	+ 5

North Central

IL, IN, IA, KS, MI, MN, MO, NE, ND, OH, SD, WI

Contract Value (millions of dollars)	1984 Actual	1985 Forecast	Percent Change 1985/84
Nonresidential Buildings			
Commercial and Manufacturing	$ 9,416	$ 9,475	+ 1
Institutional and Other	5,167	5,400	+ 5
Total	$14,583	$14,875	+ 2
Residential Buildings			
One-Family Houses	$10,720	$11,775	+10
Multi-Family Housing	3,555	3,450	− 3
Nonhousekeeping Residential	925	775	−16
Total	$15,200	$16,000	+ 5
Nonbuilding Construction			
Highways and Bridges	$ 4,766	$ 5,025	+ 5
Other Public Works	3,699	3,775	+ 2
Utilities	203	300	+48
Total	$ 8,668	$ 9,100	+ 5
Total Construction	$38,451	$39,975	+ 4

West

AK, AZ, CA, CO, HI, ID, MT, NV, NM, OR, UT, WA, WY

Contract Value (millions of dollars)	1984 Actual	1985 Forecast	Percent Change 1985/84
Nonresidential Buildings			
Commercial and Manufacturing	$12,388	$12,200	− 2
Institutional and Other	5,667	6,275	+11
Total	$18,055	$18,475	+ 2
Residential Buildings			
One-Family Houses	$17,234	$19,275	+12
Multi-Family Housing	8,060	8,975	+11
Nonhousekeeping Residential	1,888	2,000	+ 6
Total	$27,182	$30,250	+11
Nonbuilding Construction			
Highways and Bridges	$ 3,018	$ 3,275	+ 9
Other Public Works	3,590	3,650	+ 2
Utilities	574	800	+39
Total	$ 7,182	$ 7,725	+ 8
Total Construction	$52,419	$56,450	+ 8

Tax reform proposals that are apt to take back some of the incentive of accelerated depreciation add an extra element of mystery to the outlook, but such legislation is at least a year from becoming effective. In the meantime, the office market must be evaluated on the basis of current conditions.

By conventional standards, this market was overbuilt as long ago as 1981, and one consequence of accelerated depreciation was to raise the threshold of saturation. What was surplus by pre-ERTA standards became acceptable with liberalized depreciation. After three extra years of high-volume development, it is probably safe to say that the market is as overbuilt today—with the new depreciation schedules—as it was in 1981 under the former rules. If 1982's short-lived decline of contracting was any indication of developers' reaction to overbuilding, then a cutback of perhaps 15 percent (to 275 million square feet) might be appropriate for 1985's nervous market. An even larger decline would seem reasonable except for the motivation to continue building in anticipation of tax reform.

For the past two years, state and local governments have been learning how to get along with less financial help from Washington. The initial shock of the New Federalism, coming as it did when the

economy was in deep recession, led to sharp cuts in contracting for institutional building during 1981 and 1982. Recovery, which began in 1983, has been a slow process, and the future of the institutional building market (schools, hospitals, public administration buildings, etc.) depends on the capability of state and local governments to go it alone.

Over the next several years, the most positive influence on institutional building will be the gradual strengthening of demographic support in the key educational sector. The biggest risk: the likely loss of Federal Revenue Sharing funds. However, neither of these two factors will have much bearing on 1985's outcome when the continued recovery from the 1981-82 collapse will raise contracting another 6 percent to just under 300 million square feet—still below pre-1980 levels.

The 1985 forecast of total nonresidential building (commercial, industrial, and institutional building) has been increased slightly to 1,220 million square feet—a volume that is virtually even with 1984's final total. A different "mix" of building types in 1985 (fewer offices, more institutional buildings), along with an average increase in cost per square foot of 4 to 5 percent, will raise nonresidential building contract value 2 percent to $74.8 billion.

Housing: A Second Effort

The closing quarters of 1984 brought the anomaly of declining mortgage rates *and* declining housing starts. Usually when one is going down, the other is going up.

Whether the lack of homebuyer response to improving credit conditions was due to general economic uncertainty during last year's shaky second half, or the hope that still lower rates might be negotiated by holding out longer, the time to act has arrived. After its brief slowdown, the economy is back to cruising speed. Partly for that reason, interest rates are stabilizing. With homebuyers running out of reasons not to buy, it has become fashionable to look for the turnaround of the housing market in 1985's first quarter, with continuing recovery throughout the rest of the year.

Although short-term interest rates are stabilizing, mortgage rates can still edge downward a bit more. The average mortgage commitment rate, which is currently a shade under 13 percent (down from 14 percent at this time last year), is expected to decline for perhaps another quarter, leveling off between 12½ and 12¾ percent through the second half. By 1986, mortgage rates—preceded by rising short-term rates—are likely to be climbing into the 13's again.

The experience of the first half of the 1980's, a period when mortgage rates ranged from high to very high, is the best guide to the potential of the one-family housing market when mortgage rates fluctuate between 12 and 13 percent. Within this range, the credit-sensitive one-family building market cannot stretch much beyond 1.1 million units, and can also be squeezed below 1.0 million, where it is now.

Early in 1985, one-family housing starts will reverse their 1984 decline, edging past the one million unit rate in the spring quarter to finish the year at 1.1 million units. For 1985 as a whole, the expected volume of 1,050,000 one-family units would be the best of the 1980's to date—slightly better than the 1.0 million volume reached in both 1983 and 1984, and well above the depressed level that prevailed during 1980, 1981, and 1982.

Multi-family building, at a very strong 700,000-plus unit volume in 1983 and 1984, is being supported by two layers of demand—one firm, but the other undependable. Condominiums, which now make up one-third of total multi-family starts (up from one-tenth only a few years ago), have found a secure niche as the 1980's alternative to the traditional "starter home." But apartment construction, having soared into the unreal world of tax shelters since 1982, is, like offices, becoming overextended.

With accelerated depreciation continuing to support apartment building for at least another year, and lower interest rates stimulating condo sales, 1985's total of multi-family building can be expected to remain within its recent high range of 700,000 to 750,000 units. January's strong rate of contracting got 1985 off to a good start.

Total housing starts in 1985, consisting of 1,050,000 one-family homes and 725,000 multi-family units, are estimated at 1,775,000—a small increase over 1984's 1,748,000 units. Including nonhousekeeping residential buildings (hotels, motels, dormitories), total residential construction contract value will increase 8 percent in 1985 to $108.5 billion.

Public Works: Budgetary Discipline

The ICE issue, which has been threatening to disrupt highway construction for the past year, finally appears to have been resolved. But this does *not* mean that highway bridge construction is about to surge as a large block of "frozen" Federal funds is suddenly released.

It is a fact, of course, that Congress' reluctance to pass DOT's Interstate Cost Estimates (due to controversial amendments to the bill, and not because of the estimates themselves) has delayed the disbursement of several billion dollars of Federal grants for Interstate highway construction. Contracting for highway construction has not been seriously interrupted, however, mainly because state governments were able to advance the funds necessary to keep most projects moving ahead. Despite all the concern, 1984 contracting for highways and bridges was *up 13 percent* over 1983's previous record value.

The release of the blocked Federal funds in the months ahead will be of greater interest to the keepers of state and Federal government accounts than to contractors. As funds that were advanced by state highway agencies are replaced by Federal grants, 1985 contracting is likely to be close (or only slightly higher) than it would have been had the ICE issue never happened—a total of $18.0 billion for a gain of 5 percent over 1984's contract value.

The attempt to conform with last summer's Deficit Reduction Act will keep a tight lid on Federal spending for water resources (Corps of Engineers and Bureau of Reclamation) and for waste water treatment plants (Environmental Protection Agency). However, construction of water supply systems, which depends more on municipal funding, is expected to rise nearly 10 percent in 1985 in line with generally strong building activity. On balance, total public works construction will not quite keep pace with inflation in 1985, as the expected 5 percent rise in construction cost exceeds this year's 4 percent advance of contract value to $34.8 billion.

Total nonbuilding construction contract value (public works and utilities) will advance 5 percent in 1985 to $37.8 billion.

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George A. Christie
Vice President and Chief Economist

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1985 Dodge/Sweet's Construction Outlook

Second Update
July 1985

Revival In 1985

After stalling in 1984, the building market is expanding again.

The sideways movement of the Dodge Index of construction contracting through 1984 strongly suggested that after two years of expansion, the upper limit had been reached. Between 1982:II and 1984.I the Index rose from a depressed 103 to 148, but by 1984:IV it was no higher than 149. Then, like a whiff of oxygen to a tired athlete, falling interest rates revived the market. Contracting advanced 5 percent in 1985's first quarter (to a new high of 152), and was doing even better in the second (a very possible 160 in the making).

At mid-1985, the outlook for the remainder of the year is a mixture of promise and concern. The promise of still lower interest rates by year-end implies continued improvement in the reviving residential building market. The cause for concern arises out of the very reason why interest rates are being nudged down—to counteract deep-seated problems in the economy's industrial sector. With falling interest rates as the catalyst, 1985's gains in housing are coming at the expense of commercial and industrial building.

The Case For Lower Mortgage Rates

The economy clearly needs lower interest rates to restore its growth. The hard dollar (a side effect of high interest rates since the early 1980's) is seriously inhibiting industrial expansion, and business capital spending is faltering. The opportunity for monetary stimulus is also available. Inflation is dormant, and the Administration and Congress are finally coming to grips with the deficit. There are no credible arguments left for maintaining artificially high interest rates, and there is every reason for the Fed to lean in the direction of monetary ease for as long as the economy needs support. That need could linger throughout most or all of 1986.

The Federal Reserve's timely cut of its discount rate in May left little doubt as to the intent of current monetary policy and cleared the way for *continued* decline of long-term interest rates during the second half of 1985. Prior to the latest easing, it appeared that mortgage rates would be settling in the range of 12.50 to 12.75 percent this year, down from 1984's third quarter peak of 14.11 percent. Now, with the Fed's encouragement, it is reasonable to look for 12.0 percent mortgage money (maybe lower) by the end of 1985, with little upward pressure in 1986. *The implication: an already favorable housing outlook becomes even better.*

The Drag Of Growth Recession

A recent study by Data Resources, Inc. offers some dimensions of the impact that the dollar's appreciation since 1980 is having on the economy's industrial sector. Export sales are approximately 15 percent lower, and imports 15 percent higher, than if former exchange rates still prevailed. This translates into a reduction of nearly 10 percent in industrial output, and a loss of roughly 2 million production jobs.

The handicap of a large trade deficit will persist in retarding real GNP growth as long as the overvalued dollar makes imported goods attractive to consumers. Even with the help of monetary stimulus, it will take the rest of 1985 and most of 1986 to revive the economy from its lapse into "growth recession." As a result, a period of subnormal GNP growth (2 to 3 percent in constant dollars) must be endured before the more desirable 3.5 to 4 percent rate is restored. For this year's second half, growth is estimated at between 2.5 and 2.75 percent—not much different from the first half rate.

Because the term "growth recession" literally means insufficient economic expansion to absorb excess capacity (whether labor or plant and equipment),

the outlook for business capital spending has deteriorated since the rate of capacity utilization began slipping back toward 80 percent. *The implication: a setback for the commercial and industrial building sector.*

Housing Outlook

The turnaround of the housing market early in 1985 was, of course, the main thrust behind this year's renewed advance of construction contracting. By May, the rate of residential starts had topped $100 billion for three consecutive months, regaining a level that had not been reached since early in 1984.

The revival of housing activity since the end of 1984 has been dominated by the multi-family side of the market which delivered 100,000 of the 150,000 unit improvement to date. The second half of 1985 should belong to single-family housing, which still has a lot of catching up to do.

Single-family Housing: Based on recent experience, by the time the "standard" mortgage rate winds down to 12 percent (tentatively 1985:IV), the rate of one-family housing starts should be approaching 1,150,000 units (F.W. Dodge basis*). Through mid-1985, however, the response by homebuilders and buyers has been something less than recent experience would lead you to expect. With mortgage money now getting close to 12.5 percent (down from last year's 14 percent), one-family starts ought to be comfortably above 1.0 million units instead of struggling to reach 975,000.

It is not hard to rationalize the shortfall. Buyers could be responding to lower mortgage rates, by substituting condos (i.e., multi-family units) for singles. Buyers probably expect rates to go still lower, and may be holding back awhile longer. Buyers might feel insecure due to the threat of recession.

Any of these reasons could explain a delayed response to the improving credit environment, but in time, lower mortgage cost will generate more one-family demand. An annualized rate of 1,150,000 starts remains a good probability by 1985:IV, but due to sluggish response during the middle quarters of the year, 1985's total is not likely to exceed 1,040,000 one-family units.

If 1986 begins where 1985 ends, and if mortgage rates hold steady as expected, next year's one-family building volume should be closer to 1.1 million units.

Multi-family Housing: A very strong 750,000 unit rate of apartment and condominium starts in 1985's second quarter requires a further upgrading of 1985's full year potential to a total of 735,000 units.*

A rate of building this high is considered to be at least 100,000 units above basic demographic requirements for multi-family housing, as evidenced by the rising vacancy rate. Like offices, apartments have been overdeveloped since ERTA's accelerated depreciation provision offered a highly attractive tax

*The total number of newly started dwelling units reported by F.W. Dodge covers virtually the same universe as the U.S. Commerce Department's data. However, due to definitional differences in the part of the housing market that takes in townhouses, condominiums, and other newer forms of housing which do not fit neatly into traditional stereotypes, Dodge data typically show a higher proportion of multi-family units than Commerce does, and correspondingly fewer one-family units.

1985 National Estimates
Dodge Construction Potentials

Second Update
July 1985

		1984 Actual	1985 Forecast	Percent Change 1985/84
Nonresidential Buildings				
Floor Area (millions of square feet)	Office Buildings	318	295	– 7
	Stores & Other Commercial	478	531	+11
	Manufacturing Buildings	144	142	– 1
	Total Commercial & Manufacturing	940	968	+ 3
	Educational	90	95	+ 6
	Hospital & Health	70	71	+ 1
	Other Nonresidential Buildings	122	131	+ 7
	Total Institutional & Other	282	297	+ 5
	Total Nonresidential Buildings	1,222	1,265	+ 4
Contract Value (millions of dollars)	Office Buildings	$ 23,035	$ 22,025	– 4
	Stores & Other Commercial	18,496	20,925	+13
	Manufacturing Buildings	7,163	7,150	—
	Total Commercial & Manufacturing	$ 48,694	$ 50,100	+ 3
	Educational	$ 7,588	$ 8,300	+ 9
	Hospital & Health	7,128	7,500	+ 5
	Other Nonresidential Buildings	9,948	10,500	+ 6
	Total Institutional & Other	$ 24,664	$ 26,300	+ 7
	Total Nonresidential Buildings	$ 73,358	$ 76,400	+ 4
Residential Buildings				
Dwelling Units* (thousands of units)	One-Family Houses	994	1,040	+ 5
	Multi-Family Housing	759	735	– 3
	Total Housekeeping Residential	1,753	1,775	+ 1
Floor Area (millions of square feet)	One-Family Houses	1,567	1,632	+ 4
	Multi-Family Housing	725	701	– 3
	Nonhousekeeping Residential	90	88	– 2
	Total Residential Buildings	2,382	2,421	+ 2
Contract Value (millions of dollars)	One-Family Houses	$ 66,526	$ 72,850	+10
	Multi-Family Housing	27,973	28,400	+ 2
	Nonhousekeeping Residential	6,325	6,350	—
	Total Residential Buildings	$100,824	$107,600	+ 7
Nonbuilding Construction				
Contract Value (millions of dollars)	Highways & Bridges	$ 17,075	$ 18,600	+ 9
	Sewer & Water	8,079	8,700	+ 8
	Other Public Works	8,135	8,400	+ 3
	Total Public Works	$ 33,289	$ 35,700	+ 7
	Utilities	$ 2,518	$ 2,500	– 1
	Total Nonbuilding Construction	$ 35,807	$ 38,200	+ 7
All Construction				
Contract Value (millions of dollars)	Total Construction	$209,989	$222,200	+ 6
	Dodge Index (1977 = 100)	149	158	

*F.W. Dodge basis.

1985 Regional Estimates
Dodge Construction Potentials

Second Update
July 1985

Northeast — CT, ME, MA, NH, NJ, NY, PA, RI, VT

Contract Value (millions of dollars)

	1984 Actual	1985 Forecast	Percent Change 1985/84
Nonresidential Buildings			
Commercial and Manufacturing	$ 8,286	$ 8,350	+ 1
Institutional and Other	4,447	4,925	+11
Total	$12,733	$13,275	+ 4
Residential Buildings			
One-Family Houses	$ 8,683	$10,575	+22
Multi-Family Housing	3,596	3,875	+ 8
Nonhousekeeping Residential	847	850	—
Total	$13,126	$15,300	+17
Nonbuilding Construction			
Highways and Bridges	$ 3,216	$ 3,250	+ 1
Other Public Works	3,120	3,350	+ 7
Utilities	316	300	− 5
Total	$ 6,652	$ 6,900	+ 4
Total Construction	$32,511	$35,475	+ 9

South — AL, AR, DE, DC, FL, GA, KY, LA, MD, MS, NC, OK, SC, TN, TX, VA, WV

Contract Value (millions of dollars)

	1984 Actual	1985 Forecast	Percent Change 1985/84
Nonresidential Buildings			
Commercial and Manufacturing	$18,520	$19,575	+ 6
Institutional and Other	9,425	9,650	+ 2
Total	$27,945	$29,225	+ 5
Residential Buildings			
One-Family Houses	$30,301	$32,000	+ 6
Multi-Family Housing	12,611	12,125	− 4
Nonhousekeeping Residential	2,666	2,800	+ 5
Total	$45,578	$46,925	+ 3
Nonbuilding Construction			
Highways and Bridges	$ 6,086	$ 6,875	+13
Other Public Works	5,826	6,275	+ 8
Utilities	1,416	1,200	−15
Total	$13,328	$14,350	+ 8
Total Construction	$86,851	$90,500	+ 4

North Central — IL, IN, IA, KS, MI, MN, MO, NE, ND, OH, SD, WI

Contract Value (millions of dollars)

	1984 Actual	1985 Forecast	Percent Change 1985/84
Nonresidential Buildings			
Commercial and Manufacturing	$ 9,433	$ 9,525	+ 1
Institutional and Other	5,095	5,525	+ 8
Total	$14,528	$15,050	+ 4
Residential Buildings			
One-Family Houses	$10,493	$11,500	+10
Multi-Family Housing	3,585	3,775	+ 5
Nonhousekeeping Residential	930	825	−11
Total	$15,008	$16,100	+ 7
Nonbuilding Construction			
Highways and Bridges	$ 4,735	$ 5,225	+10
Other Public Works	3,668	3,700	+ 1
Utilities	208	250	+20
Total	$ 8,631	$ 9,175	+ 6
Total Construction	$38,167	$40,325	+ 6

West — AK, AZ, CA, CO, HI, ID, MT, NV, NM, OR, UT, WA, WY

Contract Value (millions of dollars)

	1984 Actual	1985 Forecast	Percent Change 1985/84
Nonresidential Buildings			
Commercial and Manufacturing	$12,455	$12,650	+ 2
Institutional and Other	5,697	6,200	+ 9
Total	$18,152	$18,850	+ 4
Residential Buildings			
One-Family Houses	$17,049	$18,775	+10
Multi-Family Housing	8,181	8,625	+ 5
Nonhousekeeping Residential	1,862	1,875	—
Total	$27,112	$29,275	+ 8
Nonbuilding Construction			
Highways and Bridges	$ 3,018	$ 3,250	+ 8
Other Public Works	3,600	3,775	+ 5
Utilities	578	750	+30
Total	$ 7,196	$ 7,775	+ 8
Total Construction	$52,460	$55,900	+ 7

advantage. The probability that current proposals for tax reform will lead to a lengthening of depreciation in 1986 will have two effects: to encourage excessive building for the balance of 1985, and to precipitate a sharp decline in 1986 when the rules change.

It will take several more months of debate before Congress and the Administration agree on the details of their tax reform program. Meanwhile, the booming apartment building market is headed for another exceptional year in 1985.

Total Residential Building: As single-family building continues to respond to falling interest rates through 1985's second half, the year's dwelling unit total is forecast to reach 1,775,000. The 1985 value of all residential building—including hotels, motels, and dormitories—will total $107.6 billion, a gain of 7 percent over last year.

Nonresidential Outlook

Commercial and Industrial Building: The economy's lapse into "growth recession" since mid-1984 is taking its toll on commercial and industrial building. From a strong 11 percent advance in 1984's first half, contracting eased to a 6 percent gain through last year's second half, and then all but ceased expanding in the first six months of 1985. A mere one percent gain during the most recent

six month period brought the annualized rate of contracting for offices, stores, warehouses, and factories to 982 million square feet—the probable peak of the current cycle. As this sensitive market is subjected to continued stress in the quarters ahead, contracting for commercial and industrial building is expected to decline by 3 percent (to a rate of 950 million square feet) in 1985's second half.

Office building heads the list of vulnerable markets, but as the deadline for tax reform nears, contracting for offices could go either way. Responding more to the laws of taxation than to the law of supply and demand, new office starts again topped 300 million square feet (annual rate) in 1985's first half despite a national vacancy rate well above 15 percent. However, with starts of large, high-rise projects diminishing, it is presumed that the interaction of two conflicting motives—the urge to qualify for 18-year depreciation, and traditional concern about soaring vacancies—will bring the rate of contracting down to about 285 million square feet in the second half (still a lot more than the market can digest). In 1986, a considerably lower rate will be appropriate.

Industrial building, another vulnerable category, may already have made its adjustment to the limitations of the mid-1980's. After a promising recovery in 1983, contracting for manufacturing buildings plateaued in 1984 at 144 million square feet—roughly three-quarters of its potential for expansion. With little prospect that capacity utilization in the manufacturing sector will rise above its current 81 percent in the next 12 to 18 months, contracting for industrial construction appears stalled in the range of 140-145 million square feet through the rest of 1985 and all of 1986 as well.

Contracting for stores, shopping centers, and warehouses is providing a stabilizing influence in the commercial and industrial building market. Linked closely to homebuilding, construction of retail facilities will be averaging a solid 450 million square feet through 1985's second half and into 1986 while residential building benefits from declining mortgage rates.

For the full year 1985, contracting for commercial and industrial building is forecast to reach 968 million square feet, the highest volume achieved since 1979. Construction contract value will advance 3 percent to $50.1 billion.

Institutional Building: The improved flow of revenue to state and local governments and the reduced cost of municipal finance together have greatly improved the outlook for institutional building. A "break-through" was achieved during 1984's second half when the rate of contracting for schools, hospitals, and public administration buildings escalated 10 percent to 300 million square feet for the first time in five years of depressed building. Educational construction delivered most of the rebound.

After a temporary setback in 1985:I, contracting for institutional building appears to be steadying at close to 300 million square feet this year.

Total Nonresidential Building: Coming off its cyclical peak of 1,293 million square feet (1984:IV), contracting for nonresidential building is slackening in 1985 while residential building recovers. Compared with the first quarter rate of 1,280 million square feet, total nonresidential square footage will still be relatively strong at 1,250 million by the final quarter, yielding a full year total of 1,265 million square feet.

The value of 1985's "mix" of commercial, industrial, and institutional contracting is estimated to reach a total of $76.4 billion.

Public Works Outlook

Slow but steady improvement in contracting for public works construction is evidence that this market is adjusting to the withdrawal of Federal funding (once called the "New Federalism"; now becoming known as the "New Localism"). In constant dollar terms, 1985's first half rate of contracting for transportation-related projects, water and sewer facilities, and other public works advanced 2 percent, extending the three-year recovery which began in 1982. With the support of additional user taxes and a greater degree of local government participation, the current level of public works construction has climbed back to within 5 percent of its pre-1980 strength.

Highways/Bridges: Once the backlog of Interstate work that was delayed by last year's ICE (the Interstate Cost Estimate) hassle is reduced, contracting for highways and bridges will be stabilizing at a rate just above $18.5 billion for the balance of the year. For 1985 as a whole, this means a gain of 4 percent in constant dollars, 9 percent in current dollars.

Water Resources: The budgets of the two Federal agencies that are responsible for most of the nation's water resource development are giving conflicting signals in 1985. Increased outlays by the Bureau of Reclamation are currently more than offsetting cutbacks in the Corps of Engineers' construction programs for dams, reservoirs, and river/harbor development. As a consequence, this year's contracting will be up 5 percent in current dollars (but unchanged from last year's constant dollar value).

Sewer/Waste Disposal: A higher required rate of local government participation in EPA's construction grant program (45 percent since last October vs. the previous 25 percent) is temporarily sustaining total contracting for waste water treatment facilities despite Federal budget cuts. In 1985, current dollar contract value will be up 7 percent, 3 percent of it "real."

Total Public Works Construction: Although next year's proposed "budget freeze" gives reason to doubt that the recovery of public works construction can continue much longer, 1985's contracting is headed for a 3 percent gain in constant dollar value. A modest 4 percent rate of inflation will boost current dollar contracting 7 percent to $35.7 billion.

Beware 1986

Midway through 1985, falling interest rates are breathing new life into the building market. This year's newly started construction, now estimated at $222 billion, will exceed 1984's total by 6 percent as the construction sector rounds another cyclical peak.

By 1986, conditions will be changing. Tax reform threatens to curtail commercial building. The proposed reduction of the Federal deficit could mean deeper cuts for all publicly funded construction. Interest rates will not decline indefinitely. Meanwhile, the benefits of lower interest rates easily outweigh any or all of the mounting threats to the continued prosperity of the construction industry.

October's *Outlook* will be the appropriate time and place to assess next year's risks. For now it is enough to appreciate the bonus of an uncommon late-cycle revival.

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McGraw-Hill Information Systems Company

George A. Christie
Vice President and Chief Economist

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